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**April 14, 2006**

**AGENDA ITEM 5a**

**TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE**

- I. SUBJECT:** Revision of the Alternative Investment Management Program to Revise Benchmarks
- II. PROGRAM:** Alternative Investment Management (AIM) Program
- III. RECOMMENDATION:** Approval of the reading and recommend to the Investment Committee approval of the Investment Policy for the AIM Program
- IV. ANALYSIS:**

**Background**

At the October 2005 Investment Committee meeting, the Investment Committee approved the Strategic Review of the AIM Program conducted by Pension Consulting Alliance (PCA). The Strategic Review recommended evaluation of AIM's benchmarks.

Staff asked Russell Investment Group (RIG) for its recommendation on the most appropriate benchmarks for the AIM portfolio. Staff sought input from Wilshire Associates on RIG's recommendation and asked PCA to review both sets of recommendations and express its conclusions.

The following documents are attached:

- Attachment 1: AIM Policy marked to show proposed changes
- Attachment 2: PCA's recommendations
- Attachment 3: Wilshire's opinion letter
- Attachment 4: RIG's benchmark report

### **AIM Benchmark Review**

Currently the AIM Program uses two benchmarks in evaluating the AIM portfolio's performance, a long term and a short term benchmark. The long-term benchmark is the 10-year rolling average for the total return of the CalPERS Wilshire 2500 Index plus a 500 basis point risk premium. The short-term benchmark is the Venture Economics Young Fund Universe median return.

RIG concluded in its report that a two benchmark approach for the AIM Program was rational and should be maintained. However, the report recommended making a number of changes to the benchmarks. Refer to Attachment 4 for a detailed discussion.

Wilshire reviewed RIG's recommendations from an overall CalPERS fund perspective. Wilshire agreed with some (not all) of RIG's conclusions. Specifically, Wilshire agreed that a two tier benchmark structure was appropriate and that the risk premium over the public equity index for the long term benchmark should be decreased from 500 basis points to 300 basis points to reflect the reduction in risk premium in the market for private equity versus public equity. Refer to Attachment 3 for Wilshire's detailed review. Following its review of all the information, PCA concurred with Wilshire's recommendations. Refer to Attachment 2 for PCA's recommendations.

In summary, PCA recommended CalPERS consider:

- Continued use of dual benchmarks (long term and short term)
- Continued use of a US equity market index when calculating the long term benchmark
- Continued use of rolling ten year periods in computing the long term benchmark
- Lowering the return premium to 300 basis points (over the public market index)
- Continued use of Venture Economics young fund median return in computing the short term benchmark

Staff concurs with PCA's recommendations.

**V. STRATEGIC PLAN:**

Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions and Goal IX, achieve long-term, sustainable, risk-adjusted returns.

**VI. RESULTS/COSTS:**

No costs are associated with this item.

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Sarah Corr  
Portfolio Manager

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Leon G. Shahinian  
Senior Investment Officer

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Anne Stausboll  
Interim Chief Investment Officer